Comments Regarding Consumer Information Flows

Comments of
Solveig Singleton[1]
Competitive Enterprise Institute[2]
1001 Connecticut Ave. N.W. Ste. 1250

June 17, 2003

Hard-To-Measure Aspects of Information Flows

Introduction & Summary

These comments address aspects of consumer information flows likely to be obscured by various analyses and studies completed at this stage of the debate. We move from the concrete to the (hopelessly) theoretical. First, some benefits of the movement of consumer information through the economy, particularly its role in enhancing competition, are likely "off the radar" of any individual companies the FTC might hear from, let alone consumers. Second, other qualities of business's activities in learning about consumer behavior are likely to be misapprehended, under the influence of slippery economic concepts such as "information costs" or "market failure." Third, there is the whole question of political values and human rights and its relationship to economics costs and benefits.

Taking this "Big Picture" view, when the known, the scarcely known, and the unknowable are tallied up, there is (still) little evidence to support broad restrictions on consumer information flows, any more than there would be to support a substantial extension of copyright laws to facts and ideas.

[1] Solveig Singleton is a lawyer and senior analyst at the Competitive Enterprise Institute. She is the author of many articles on the conflict between privacy and the free movement of consumer information through the economy.
[2] The Competitive Enterprise Institute is a nonpartisan policy analysis organization, dedicated to the principles of limited constitutional government and free enterprise. The Institute is a nonprofit educational foundation.

I. Counting Costs and Benefits: From Fish to Ocean

Empirical studies thus far confirm that businesses use consumer information to cut costs and junk mail by targeting marketing, to offer discounts, to customize products, to control risk and fraud, and to save consumers' time.[3] Think of these somewhat isolated glimpses of uses of information as fish. What does the ocean look like?

From the standpoint of consumers and the economy as a whole, the (relatively) free movement of consumer information through the economy that has been the default rule in the United States for at least two centuries plays a key role in enhancing competition. Entrepreneurs use it to bring new firms into existence; existing firms use it to develop new products. Whether or not consumer information is available to target marketing efforts can often determine whether it is cost effective to bring a product to market at all, whether the product is a set of windshield wipers or a mortgage designed for first-time home buyers. This is why the Federal Communications Commission, in trying to bring competition to telephone markets, was instructed to require telephone companies to share information with their competitors. If new entrants cannot identify their first customers, they will find it very difficult to proceed.

Add this to what we already know from empirical studies of advertising more generally. Once, it was believed that advertising was largely a waste. But the FTC itself in the 1970s and 1980s began to recognize that advertising enhanced competition by informing consumers about prices and products.[4] Even the most biased ad will tell someone the name of the product and what it does. So studies have shown advertising means lower prices, more choices, and higher quality. When we think of advertising we most often think of television—but broadcasting advertising to everybody is too expensive for anything but mass-market products like cars, houses, and detergent. To bring the informational benefits of advertising into more niche markets, it will be targeted and tailored using consumer information.

The FTC has heard today from a number of companies that put consumer information to various useful purposes. But the importance to consumers of

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[3] See, e.g., Ernst & Young for the Financial Services Roundtable, Customer Benefits from Current Information-Sharing by Financial Services Companies, December, 2000, available at http://www.bankersround.org/PDFs/custbenefits.PDF; A study of the apparel industry estimates that an "opt-in" rule would effectively impose a $1 billion dollar tax on catalog and Internet clothing sales as businesses passed on an increase in costs from 3.5 to 11 percent. Michael A. Turner, "The Impact of Data Restrictions on Consumer Distance Shopping," 2001, available at www.understandingprivacy.org in spring, 2001.

[4] See John E. Calfee and Debra Jones Ringold, "The 70 percent Majority: Enduring Consumer Beliefs About Advertising," 13 JOURNAL OF PUBLIC POLICY AND MARKETING 228 (1994); John E. Calfee, *Fear of Persuasion: Advertising and Regulation* (1997)(describing empirical studies of the benefits of advertising for consumers).

these present efforts is just the tip of the iceberg, compared to the beneficial uses of information that will be made by businesses and services that do not yet exist. I am sure that some of you will be skeptical of this proposition. But consider that if businesses had been prevented from sharing information about consumers early in the twentieth century, credit reporting could never have developed. The credit system today is not perfect, but it is vastly preferable to the state of affairs then.

The relatively free movement of consumer information between companies, then, is the stuff of competition. Where does this fit in with economic theory?[5] It fits in nicely with some of the key insights of economists of this century, assessing markets as a mechanism for relaying information. These economists include the Nobel Prize winner F. A. Hayek, who explained the role that prices play in relaying information through the economy and who emphasized the value of "local knowledge." They also include Israel Kirzner of New York University, who describes the market as a process of discovery. There is the old line about the economist who thought it would be impossible for there to be a dollar lying on the sidewalk, because someone would have already picked it up. But in fact in the real economy the dollars lying on the sidewalk are not that easy to see. Contacts between businesses and consumers enabled by consumer information let both see better.

Suppose we take everything argued above as non-controversial. A pessimist might still note—quite correctly, that uses of consumer information have costs as well as benefits. Making a full calculation of these is not the intent of these comments. But it is important, when they are added up, to take account of the unseen along with the seen. My purpose here is to ensure that larger concepts of competition are counted with the beneficial unseen.

II. Are the Rose Colored Glasses Half Empty of Half Full? What Economic Lens?

Regardless of the benefits and costs of flows of consumer information, the FTC would not normally have to worry about it, assuming markets are working as they usually do. But suppose one were to argue that, the calculable benefits of consumer information to aside, that keeping information confidential is also a good, and that the failure of markets to provide this for financial information or consumer information more broadly is evidence of a market failure. This immediately raises several thorny methodological problems; some are obvious, but others have often been the occasion for more subtle economic fallacies.

[5] I dislike to disappoint Peter Swire, who has written to this effect, but none of this has to do with "perfect information." "Perfect information" is an academic construct, useful for some explanatory purposes, but of little relevance to the real world.

To start with, consider the assertion that confidentiality is a good. It cannot be an absolute good, so what it its value relative to the benefits of information flows? One might say that consumer opinion polls on privacy are evidence that it is a greater good than the benefits of information flows.[6] But those answering the queries of pollsters do not bear any of the costs of expressing their preference. Hence, to grossly truncate a series of methodological arguments following James Buchanan, polls are not a particularly good indication of anything.

One might argue that market failures occur when property rights are not defined. And consumers have no exclusive right in information about themselves. One might say, that, therefore, that privacy is a positive externality. But this quickly becomes tricky. Is privacy always a *positive* externality? If consumers were able to veto businesse's attempts to learn about their behavior by asserting a property right in their information, wouldn't that produce substantial negatives? The full cost of those negatives would not be borne by the consumer. One could make an equally good argument that privacy taken too far becomes a *negative* externality, and that the goods of information exchange—competition, security, being able to locate witnesses and fleeing judgment debtors, donors to political groups and charities and start magazines targeted at unicycle enthusiasts or amateur astronomers, since they depend not on the contribution of any one individual's personal information, but on the functioning of the system as a whole, have many of the qualities of public goods.

Finally there is the question of information costs and / or transaction costs, which in the staples of law and economics is readily accepted as a type of market failure. Perhaps more confidentiality is not offered because of problems in these departments? Perhaps. But here, too, there are problems.

A) While lawyers with limited economic training readily accept that market failures due to high information or transaction costs are common, ironically, economists that have made a serious study of market failures have more difficulty.

- From Coase to Gordon Tullock, authorities on economic methodology question the relevance of using a world of perfect information or zero transaction costs as a standard by which to judge the efficiency of our world.[7] Why a world of zero information

[6]James Harper and Solveig Singleton, "With a Grain of Salt: What Consumer Privacy Surveys Don't Tell Us," June 1, 2001.

[7]Ronald Coase, "The Coase Theorem and the Empty Core: A Comment," 24 J. L. & ECON 183, 187 (1981) ("[W]hile consideration[s] of what would happen in a world of zero transactgion costs can give us valuable insights, these insights are, in my view, without value except as steps on the way to the analysis of the real

costs rather than a world of zero labor costs or transportation costs? Information and transactions are scarce resources like any others.

- Empirical economics have shown that markets seem to be quite good at resolving their own "failures" due to information costs. If information is scarce and valued, markets tend to produce it.[8] And as a result over time real markets failures seem to scarce indeed.

B) The market does in fact produce a wide range of the goods variously known as privacy. The chief of these is security; banks and other firms do not commonly shout out information about accounts on the street, nor publish them in the newspaper; information sharing is by and by large limited to other legitimate businesses that value the exchange precisely because they believe that ultimately consumers will value the exchange. There are passwords and PINs, very good spam filters and mailing houses. Most legitimate email marketing (for example, Eddie Bauer's) is opt-in. What is left for the alleged "market failure" to fail to provide is the kind of broad restrictions on information flows of the sort imposed by law in the European Union. But, again, it is not clear what use thesebroad restrictions serve or why consumers would demand them. They do not effectively address any particular real problem, like spam or identity theft, both of which are in large part enforcement problems.[9]

In short, if one argues that transaction costs or information costs are too high, and that this prevents a valuable good from being produced, one *must* know "the value" of the good and "the cost" of transacting or informing (as if these have some fixed measure). In the argument about the free flow of information versus privacy, no one who has asserted that there is a market failure has any such information (nor does anyone else). Assertions of market failure in this context are mostly a matter of wanting the outcome that reflects consumer preferences to be something other than it is, for reasons that have more to do with political values than economics.

III.: The Human Rights Issue.

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world of positive transaction costs."); see also Harold Demsetz, "Information and Efficiency: Another Viewpoint," 12 J. L. & ECON 1 (1969)(explaining the "Nirvana Fallacy"); Gordon Tullock, "The Two Kinds of Legal Efficiency," 8 HOFSTRA L. REV. 659, 668 (1980).

[8] *The Theory of Market Failure: A Critical Examination* (Tyler Cowen ed., 1988)(describing the rarity of market failures and the difficulty of identifying examples); Barzel, "Some Fallacies in the Interpretation of Information Costs," 20 J.L. & ECON. 291 (1977) (showing how markets respond to problems of inefficient search).

[9] Solveig Singleton and Hanah Metchis, "**Spam, That Ill O' The ISP**," CEI Studies, May 21, 2003.

Now we turn to some of these political values. How should we answer the question of whether economic considerations of cost and benefit should trump political values? How can we say that transfers of consumer information through the economy are more beneficial than a fundamental value like privacy? Isn't privacy a basic right, a matter of human dignity?

This line of thinking, though, does a disservice to human rights by divorcing it too far from real human experiences. There are some aspects of privacy, such as the Fourth Amendment, that solve real and particular problems with the abuse of power (in the case of the Fourth Amendment, it was the "general warrant"). But restrictions on businesses learning about consumer preferences to sell them goods and services don't fall into that category. Slavery and torture are real threats to human dignity, but Safeway knowing that we've bought lettuce is not. People are tougher than that. And in the private sector, the free movement of information certainly competes with privacy for the "supreme value" category.

The "values trump efficiency" is a seductive argument because we live in a country where most of us, particularly most of us in this room, enjoy a relatively high standard of living. It is easy to take material comfort for granted in that environment. But its good to remember that even here, the lower costs of credit and houses and good have not reached throughout society.

IV. Conclusion

Talking about the value and function of consumer information flows brings us right up against the limits of what we know. We do not know exactly what businesses or products would develop in the future by using new forms of consumer information. We don't know about new crimes that will develop in the future to take advantage of this, either. But keeping a general presumption in favor of the freedom of information and of learning and trying to understand what consumers want will not prevent us from addressing particular problems as they arise. As a general rule, people should be free to learn about other people, and facts and ideas should be a part of the shared realm of information.

Submitted by

Solveig Singleton
Senior Analyst
CEI
(202) 331-2274
ssingleton@cei.org